

TEACHERS' RETIREMENT BOARD  
INVESTMENT COMMITTEE

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SUBJECT: Update on Legislation

ITEM NUMBER:   7  

ATTACHMENT(S):  2 

ACTION:  X 

MEETING DATE: March 6, 2002

INFORMATION:       

PRESENTER: Ed Derman

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**SUMMARY**

Staff has prepared the attached analysis and recommended position on the following measure for the Board's consideration.

<u>Attachment</u>	<u>Bill Number</u>	<u>Author</u>	<u>Subject</u>
1	SR 22	Dunn	Restrictions on Investments in Energy Companies
2	Legislative Summary		

Mr. Derman will provide a verbal update at the meeting.

**Senate Resolution 22**

**Senator Dunn (As introduced 9/14/01)**

**Position:**

**Support, if Amended (Staff recommendation)**

**Proponents:**

**None known**

**Opponents:**

**None known**

**SUMMARY**

Senate Resolution 22 requests the California State Teachers' Retirement System (CalSTRS), the California Public Employees' Retirement System (CalPERS), and other state agencies consider ending their investments in any company that participates in the wholesale energy market and does not comply with the requirements of a subpoena issued by the Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market (Select Committee).

**HISTORY**

AB 107 (Knox—2000) would have prohibited new or additional investments in tobacco companies by CalSTRS and CalPERS on and after January 1, 2001, and would have required the divestment of existing tobacco investments by July 1, 2002. It also would have provided indemnification for CalSTRS and CalPERS board members.

AB 2745 (Kaloogian—2000) would have required CalSTRS and CalPERS to investigate and report to the Legislature with respect to investments in foreign companies that pose a threat to national security.

SB 1928 (Haynes—2000) would have required CalSTRS and CalPERS to investigate and report to the Legislature with respect to investments in foreign companies that pose a threat to national security.

Chapter 1200, Statutes of 1982 (SB 211—Keene) enacts provisions relating to the personal liability of members of the Teachers' Retirement Board (Board).

**CURRENT PRACTICE**

The fiduciary standards in the Teachers' Retirement Law (TRL) require the Board, CalSTRS officers and employees to discharge their duties with respect to the System solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits, and to defray reasonable expenses of administering the plan. The Board is also governed by Article XVI, Section 17 of the state Constitution, which requires that a retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

These fiduciary standards require members of the Board to act with the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims. They must diversify CalSTRS' investments so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so. The TRL also provides, under certain circumstances, for the personal liability of a board member for breach of the prescribed duties and responsibilities, or a breach of fiduciary duty.

## **DISCUSSION**

Specifically, Senate Resolution 22 makes the following findings:

- The Legislature has the authority to issue subpoenas to gather information on matters of public policy so they may take appropriate action.
- Individuals and companies doing business in California have a responsibility to support California institutions and processes (i.e., complying with legislative subpoenas).
- The State should disassociate itself from those doing business in California that refuse to cooperate with its institutions and processes.
- The State Senate created the Select Committee to Investigate Price Manipulation of the Wholesale Energy Market to identify legislative remedies to California's energy crisis.
- Certain participants in the wholesale energy market subpoenaed by the Select Committee have impeded the Legislature's ability to solve the energy crisis by failing to appear before the committee, comply with its requests, or raise a proper claim of privilege.
- State agencies invest in businesses that participate in the wholesale energy market.

As a result of these findings and as an expression of intent by the State Senate, SR 22 requests that CalSTRS, CalPERS, and other state agencies immediately consider divesting themselves of any stocks, shares or financial investments, and terminating any joint venture, partnership, or similar business arrangement with any company, its subsidiary or affiliate, that does not comply with the requirements of a subpoena issued by the Select Committee.

### The Select Committee

For the 2001-02 legislative session, the California Senate established an eight member Select Committee to Investigate Price Manipulation of the Wholesale Energy Market (Select Committee), to find the causes of the state's energy crisis during the winter and spring of 2001, and to formulate legislation that would remedy the problems that caused the energy crisis. SR 14, which passed the Senate 29-6 on July 19, 2001, gave the Select Committee subpoena power to assist in their investigation.

According to legislative staff, the Select Committee has subpoenaed 16 former board members of the California Independent System Operator (ISO), consisting of industry representatives, to

appear at their meetings, and served subpoenas to eight wholesale energy trading firms for documents relating to their trading strategies and business practices. The eight firms are AES, Duke, Dynegy, Enron, Mirant, NRG, Reliant, and Williams. As of December 31, 2001, CalSTRS' holdings in the eight companies under investigation by the Select Committee were approximately \$237 million, about two-tenths of a percent of the total market value of CalSTRS' investment portfolio. Although six firms have not fully complied with the Select Committee's requests, it has only found Enron in contempt. It has requested (1) the Attorney General to conduct a criminal probe into allegations of document shredding by Enron, and (2) formal action by the full Senate to find the company in contempt. According to recent newspaper accounts, Senator Dunn, Chair of the Select Committee and author of SR 22, has asked the Senate to approve fines of \$1 million per day and criminal charges against company executives.

#### CalSTRS Corporate Governance

Last summer, CalSTRS' Chief Investment Officer joined representatives from CalPERS in meetings with the executives of the energy trading firms. Their discussions focused on the duties they have as responsible corporate citizens and the actions that are in their best long-term corporate interest and the California economy as a whole. Divestment by the Board would not increase the probability that an affected company would comply with a legislative subpoena and does little to improve the sort of dialogue previously undertaken by CalSTRS and CalPERS. In fact, divestiture removes any influence that the retirement systems may have as major shareholders, either on their own or acting jointly, on the behavior of corporate officers or operations of the company.

The Board is required by the state Constitution to undertake due diligence on complex and serious issues regarding the appropriateness of different types of investment securities and investment strategies. By asking it to consider divestment of companies that fail to comply with a legislative subpoena, the state Senate asks the Board to decide the point at which the Legislature's ability to gather information outweighs the negative impact to the CalSTRS' portfolio. This does not appear to be a matter of social injury similar to other issues raised by the Legislature in recent years. While the Board may consider action on these grounds, it is outside the scope of CalSTRS' investment criteria as outlined in the Statement of Investment Responsibility. As a result, absent a major change in the Board's policy, it is very unlikely that CalSTRS would decide to divest itself from a firm that failed to comply with the subpoena. An alternative to divestiture that might affect the firm's behavior would be to increase the level of corporate governance activity by the Board, including direct communications with the firms' board of directors, or a request by the Board that the firm's management appear before the Board to explain why it has not complied with the subpoenas.

#### **FISCAL IMPACT**

Benefit Program Costs – While the performance of the investment portfolio affects the ability to fund the benefits CalSTRS may offer its membership, SR 22 does not directly impact the benefit programs.

Administrative Costs – Considering whether to divest itself of specific investments would not impose significant administrative costs. However, if CalSTRS divested itself of non-complying

companies, the Teachers' Retirement Fund would experience investment opportunity costs. There also could be major costs associated with removing companies found in non-compliance by the Select Committee transitions from CalSTRS' portfolio. In addition, divestment would require ongoing staff time to monitor the activity of fund managers to ensure that the restricted equities are not purchased. Finally, there would be potential transaction costs to restore the firms to the portfolio once the firms complied with the subpoenas. This removal would also necessitate substantial changes to the Investment Management Plan.

## **RECOMMENDATION**

Support, if amended to instead request that CalSTRS take appropriate corporate governance action against any company, its subsidiary or affiliate, that does not comply with the requirements of a subpoena issued by the Select Committee to Investigate Price Manipulation of the Wholesale Energy Market. Given the Board's fiduciary duty to CalSTRS members, it is unlikely that it would determine that divesting itself of its investment in firms that did not comply with the Senate subpoena would be appropriate. Maintaining CalSTRS' status as a shareholder and increasing its level of corporate governance activity could be more effective in changing the firm's behavior.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM  
LEGISLATIVE SUMMARY – INVESTMENT COMMITTEE  
**2001-2002 Regular Session – February 14, 2002**

[illegible]

SJR 9            AUTHOR:     Senator Costa  
                  TITLE:       Foreign investments  
                  LOCATION: Senate B, C & IT  
                  BOARD POSITION: Support, if amended\*

**SUMMARY:** Requests that the President and Congress identify and place on a federal list, investments in foreign businesses that pose a threat to the national security interests of the U.S. and to encourage appropriate federal measures to deny these entities access to capital from the U.S.

**COSTS:** Benefit program – None

Administrative – No direct fiscal impact.

P – CalPERS  
O – None known

SR 22      AUTHOR:      Senator Dunn  
                  TITLE:      Investments in wholesale energy companies  
                  LOCATION: Senate E, U & C  
                  BOARD POSITION: Support, if amended (Staff recommendation)

SUMMARY: Requests that each state agency, including CalSTRS, determine whether or not to continue to own stocks, shares or other financial investments in or participate in a joint venture or partnership with any wholesale energy related business that has refused to comply with a subpoena issued by the Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market.

COSTS: Benefit program – None

Administrative – None

P – None known  
O – None known

## LEGEND OF ABBREVIATIONS

P = PROPONENTS    O = OPPONENTS

<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
AARP	American Association of Retired Persons, State Legislative Committee
AALA	Associated Administrators of Los Angeles
ACCCA	Association of California Community College Administrators
ACSA	Association of California School Administrators
AFSCME	American Association of State, County and Municipal Employees
AFT	American Federation of Teachers
AGENCY	State and Consumer Services Agency
A.R.E.	Association of Retirees for Equity
ART	Association of Retired Teachers
BOE	Board of Equalization
BOG	Board of Governors, California Community Colleges
Cal-Tax	California Taxpayers Association
CalPERS	California Public Employees' Retirement System
CALPIRG	California Public Interest Research Group
CalSTRS	California State Teachers' Retirement System
CASBO	California Association of School Business Officials
CCA	Community College Association
CCAE	California Council for Adult Education
CCC	California Community Colleges
CCPOA	California Correctional Peace Officers Association
CFA	California Faculty Association
CFT	California Federation of Teachers
CNEC	California Network of Educational Charters
CPCA	California Police Chiefs' Association
CPFFA	California Professional Firefighters Association
CRTA	California Retired Teachers Association
CSAC	California State Association of Counties
CSBA	California School Boards Association
CSEA	California School Employees Association
CSL	California Senior Legislature
CSU	California State University
CTA	California Teachers Association
DOE	Department of Education
DOF	Department of Finance
DGS	Department of General Services
DPA	Department of Personnel Administration
FACCC	Faculty Association of California Community Colleges
F.A.I.R.	Faculty Attempting to Improve Retirement
FCPHE	Faculty Coalition for Public Higher Education
FTB	Franchise Tax Board

## LEGEND OF ABBREVIATIONS

P = PROPONENTS    O = OPPONENTS

<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
LACCD	Los Angeles Community College District
LADSA	Los Angeles Deputy Sheriffs' Association
LAUSD	Los Angeles Unified School District
OCDE	Orange County Department of Education
PARS	Public Agency Retirement System
PERF	Public Employees Retirement Fund
PORAC	Peace Officers Research Association of California
RPEA	Retired Public Employees Association
SACRS	State Association of County Retirement Systems
SBMA	Supplemental Benefit Maintenance Account
SCSA	State and Consumer Services Agency
SDCOE	San Diego County Office of Education
SEIU	Service Employees International Union
SLC	State Lands Commission
SSC	School Services of California
SSDA	Small School Districts' Association
START	State Teachers' Automation Redesign Team
TRB	Teachers' Retirement Board
TRF	Teachers' Retirement Fund
TRL	Teachers' Retirement Law
UTLA	United Teachers of Los Angeles

### **STANDING COMMITTEES OF THE ASSEMBLY/SENATE**

Assembly PER&SS	Assembly Public Employees, Retirement and Social Security Committee
Senate B, C & IT	Senate Banking, Commerce and International Trade Committee
Senate E, U & C	Senate Energy, Utilities and Communications Committee
Senate PE&R	Senate Public Employment and Retirement Committee